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No. 85-592

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

NATURAL GAS PIPELINE COMPANY OF AMERICA,
Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

REPRINTED COPY

On Petition for a Writ of *Certiorari* to the United States Court of Appeals for the District of Columbia Circuit

BRIEF OF *AMICUS CURIAE*

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BRIEF OF *AMICUS CURIAE*

This *amicus curiae* brief is respectfully submitted pursuant to Rules 21 and 36 of this Court by the Interstate Natural Gas Association of America ("INGAA") in support of the Petition for Writ of *Certiorari* of Natural Gas Pipeline Company of America ("Natural").

INTEREST OF *AMICUS CURIAE*

INGAA is a nonprofit national trade association representing virtually all of the major long-distance natural gas transmission companies in the United States. These companies are subject to the regulatory jurisdiction of the Federal Energy Regulatory Commission ("Commission" or "FERC") under the Natural Gas Act ("NGA") (15 U.S.C. § 717, *et seq.* (1984)), the Department of Energy Organization Act (42 U.S.C. § 7101, *et seq.* (1978)), and the Natural Gas Policy Act of 1978 ("NGPA") (15 U.S.C. § 3301, *et seq.* (1984)). A list of INGAA's membership is set forth in the Appendix to this brief.

The Commission's orders, affirmed by the United States Court of Appeals for the District of Columbia Circuit ("Court of Appeals"), deny a pipeline's attempt to recover through its rates costs which were prudently incurred by the pipeline in developing alternate supplies of natural gas to better assure its customers a reliable, long-term supply of natural gas pursuant to its service obligation under Section 7 of the NGA, 15 U.S.C. § 717f (1984). This same service obligation applies to all natural gas pipelines subject to the Commission's jurisdiction. Moreover, the Commission routinely allows electric utilities to recover similar prudently incurred costs under comparable provisions of the Federal Power Act ("FPA"), 16 U.S.C. § 791a *et seq.* (1985). Because the decision of the Court of Appeals has ramifications that extend beyond the facts of this case to the entire interstate natural gas pipeline industry, INGAA is filing this brief *amicus curiae*.

CONSENT OF PARTIES

INGAA has obtained the consent of all parties as required by Rule 42 of this Court. These letters of consent have been filed with the Clerk of the Court.

ARGUMENT

The Court of Appeals affirmed a decision by the Commission which denied, in a rate proceeding under the NGA, any recovery of expenses incurred by Natural in pursuing several gas supply projects.[1] Natural proposed a five-year amortization of approximately $13 million in expenses already incurred (no effort was made by Natural to include these costs in rate base and, therefore, its rate-payers would not bear the carrying costs on that amount). The projects were a synthetic natural gas ("SNG") plant, a liquified natural gas ("LNG") import arrangement, and an Alaskan gas pipeline. All three projects are typical of projects which interstate pipelines turned to with the Commission's encouragement, especially during the severe supply shortage of the 1970's, in an effort to assure adequate reserves to meet ongoing contractual and public service obligations.[2] In Natural's case, as events progressed, all three projects were aban-

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[1]The Commission's decision is found in *Natural Gas Pipeline Company of America*, Opinion No. 218, 27 FERC ¶61,201, *rehearing denied*, Opinion No. 218-A, 28 FERC ¶61,020 (1984). The Court of Appeals affirmed the Commission in *Natural Gas Pipeline Company of America v. Federal Energy Regulatory Commission*, 765 F.2d 1155 (D.C. Cir. 1985). *See*, Appendix A to Natural's Petition.

[2]As indicated *infra*, page 11, government figures show that the inadequacy of reserves continues despite a current deliverability surplus.

doned—the SNG plant because necessary state permits could not be obtained and because environmental protection requirements changed; the LNG plant because costs for continued participation escalated far beyond original projections; and the Alaskan pipeline because a different route was selected by the Commission.

It is not disputed that Natural acted prudently both in the commencement and in the termination of each project. Nonetheless, the Commission disallowed all costs associated with each project. In doing so it found that the projects were "speculative and uncertain, remote in time, and without benefit to ratepayers."[3] This decision stands in contrast both to the Commission's prior and correct policy of allowing recovery of similar costs arising from other unsuccessful gas supply projects and its current policy relative to abandoned electric generating projects.

If allowed to stand, the *Natural* case will seriously and unfairly impair the ability of pipelines to assure adequate long-term supplies of natural gas to existing customers and to compete with other energy suppliers, including electric utilities, for new customers. Such a policy can only discourage interstate pipelines from undertaking innovative alternate supply projects. This will work to the disadvantage of the ultimate consumer during periods of supply shortfall which are inevitable in a cyclical industry. Such a shortfall could very well result in nationwide gas curtailments similar to those experienced during the 1970's.[4]

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[3]27 FERC at 61,379.

[4]INGAA notes that other cases have made clear that the Com-

A. The Commission Permits Cost Recovery under the Federal Power Act in Similar Circumstances for Competitive Projects of Electric Utility Companies

The Commission's disallowance of costs in this case is arbitrary and capricious because it creates an unjustifiable distinction between two competing industries it regulates under substantially identical statutory standards.[5] Under the FPA, the Commission has routinely permitted recovery of expenses associated with abandoned electric power generating proj-

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mission intends to apply its short-sighted policy industry-wide. The Commission recently has denied recovery of costs associated with a coal gasification project in *Transwestern Pipeline Company*, 28 FERC ¶61,086 (1984) (currently on appeal to the United States Court of Appeals for the Fifth Circuit in *Transwestern Pipeline Company v. Federal Energy Regulatory Commission*, No. 84-4753); with an LNG import project in *Algonquin Gas Transmission Company*, Opinion No. 233, 31 FERC ¶61,221, *rehearing denied*, Opinion No. 233-A, 33 FERC ¶61,083 (1985); and with another LNG import project in *Tennessee Gas Pipeline Company, a Division of Tenneco, Inc.*, Opinion No. 240, 32 FERC ¶61,086 (1985). *See also Transcontinental Gas Pipe Line Corporation*, Opinion No. 801, 58 FPC 2038 and Opinion No. 801-A, 59 FPC 1237 (1977), *aff'd, Tennessee Gas Pipeline Company v. Federal Energy Regulatory Commission*, 606 F.2d 1094 (D.C. Cir. 1979), *cert. denied*, 445 U.S. 920 and 447 U.S. 922 (1980).

[5]Electric rate matters come under Commission jurisdiction under the FPA. This Court has noted that the rate provisions of the FPA and the NGA "are in all material respects substantially identical." *Federal Power Commission v. Sierra Pacific Power Company*, 350 U.S. 348, 351 (1956). *See also Arkansas Louisiana Gas Company v. Hall*, 453 U.S. 571, 577 n.7 (1981). The Court of Appeals has noted that the rate provisions of the two statutes are "treated by the courts as identical in substance." *City of Winnfield, La. v. Federal Energy Regulatory Commission*, 744 F.2d 871, 875 (D.C. Cir. 1984).

ects, including nuclear projects.[6] *See, e.g., Union Electric Company,* 8 FERC ¶63,026 (1979), *aff'd,* Opinion No. 94, 12 FERC ¶61,239 (1980); *New England Power Company,* Opinion No. 49, 8 FERC ¶61,054 (1979), *aff'd, sub nom. NEPCO Municipal Rate Committee v. Federal Energy Regulatory Commission,* 668 F.2d 1327 (D.C. Cir. 1981), *cert. denied,* 457 U.S. 1117 (1982).[7]

The efforts by the Commission and the Court of Appeals to rationalize the different results reached under substantially identical statutes are of no avail. First, the Commission explains that a certificate is required for some gas supply projects, and that if a project does not or cannot receive a certificate, costs should not be included. At the same time, the Commission takes the position that because electric generating plants are not subject to any Commission-issued certificate, there is no basis for rejecting costs associated with a prudent but abandoned generating project. 27 FERC at 61,380. The Court of Appeals condoned this distinction as providing a "straightforward" rationale for the disparate treatment attended. 765 F.2d at 1166. This completely overlooks the fact

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[6]"In the electric rate-making area, the Commissioner's policy has been to allow public utilities to recover prudently incurred investment costs in a generating project that is ultimately abandoned or cancelled." *New England Power Company,* Opinion No. 231, 31 FERC ¶61,047, 61,081 (1985) (footnote omitted).

[7]In *NEPCO,* the Court of Appeals rejected arguments to include project expenditures in rate base (thus permitting a return to be earned), but accepted without question the Commission's approval of a five year amortization of expenses incurred. Such amortization is identical to the proposal made herein by Natural but rejected by the Commission and the Court of Appeals.

that two of Natural's projects did not require a certificate. However, notwithstanding the certificate rationale, it remains that a pipelines' prudent expenditures to obtain certificates for gas supply projects should be afforded more favorable treatment than similar expenditures by electric utility companies, since the latter companies do not have to consult the Commission before embarking on multi-billion dollar energy projects. Moreover, once a pipeline accepts a Commission-issued certificate, it *must* go forward with the project unless the Commission authorizes the abandonment of the project. NGA Section 7(b), 15 U.S.C. § 717f(b) (1984). While there may be no "direct analogue" to expenses in pursuit of a certificate, 765 F.2d at 1166, that certainly does not support less favorable cost recovery for prudent pipeline expenditures. Prior to the issuance of a certificate, natural gas projects are on the same footing as electric projects in that the decision to proceed is made solely by the utility's management.

Turning to the two projects of Natural's for which certificates were *not* required, the Commission purports to justify its discriminatory treatment by arguing that projects outside its jurisdiction may end up providing gas for other than Commission-regulated transactions, whereas electric utility companies' sales will be regulated either by the Commission or by states. 27 FERC at 61,380. On this basis, the Court of Appeals agreed that failure of any such project means its costs cannot be recovered in rates. 765 F.2d at 1166-67. This disingenous argument ignores the fact that electric generating plants are also nonjurisdictional, FPA Section 201(b)(1), 16 U.S.C. § 824(b)(1)(1985), and that nothing in the record dem-

onstrates that the pipelines' opportunities to make non-jurisdictional sales are greater than those available to electric utilities. The Commission and the Court of Appeals erred in assuming that the gas supply from Natural's projects, if successful, would have been sold in nonjurisdictional transactions.

Beyond the foregoing errors, the Commission's decision fails to recognize that natural gas pipelines and electric utility companies frequently compete for customers. This is not only true of residential and commercial customers but also industrial energy users. Yet nothing in the Commission's or the Court of Appeals' decisions provides any justification for hamstringing pipelines in their efforts to compete in the energy markets.

Consequently, this case presents this Court with undue discrimination in the regulatory treatment which the Commission accords to natural gas pipelines as compared with the treatment it accords to electric utility companies. The repeated and strained efforts of the Commission and the Court of Appeals to deny a pipeline the recovery of its prudently-incurred unsuccessful project costs both illustrate the fundamental inequity in the orders below and lead further away from the central issue. Interstate natural gas pipelines should not suffer such treatment when the present and future public interest demands that pipelines take advantage of all supply opportunities in order to assure their future certificate obligations.

B. Interstate Natural Gas Pipelines Must Undertake Gas Supply Projects To Meet Obligations Arising Under Certificates of Public Convenience and Necessity

The need for interstate pipelines to incur costs for new gas supply projects stems from obligations attending certificates of public convenience and necessity issued by the Commission pursuant to Section 7 of the NGA. Pipelines holding such certificates have, independent of their private contract obligations, a public interest obligation to assure sufficient supply to meet certificated service requirements. *Gulf Oil Corporation,* Opinion No. 692-A, 52 FPC 593, 596 (1974); *see also, California v. Southland Royalty Company,* 436 U.S. 519 (1978). The Commission has repeatedly reminded pipelines that they have a primary obligation to obtain gas supplies. In one case, the Commission stated:

> "The Commission has traditionally placed the primary responsibility for a long-term balancing of gas supply and demand upon the interstate pipelines. * * * Although the Commission's direct jurisdiction over [certain] sales has been partially removed, *the pipeline's responsibility to its customers to acquire an assured long-term supply of gas under favorable terms remains.* * * *" *Tennessee Gas Pipeline Company, a Division of Tenneco, Inc.,* 21 FERC ¶61,004, 61,006-61,007 (1982) (emphasis added, footnote omitted), citing Sales and Transportation by Interstate Pipelines and Distributors, FERC Statutes & Regulations, ¶32,132, 33,191 n.11 (1981).

Also, compare the Commission's decision in *Columbia Gas Transmission Corporation,* 26 FERC ¶61,034 (1984), where the Commission reaffirmed the continuing duty of pipelines to assure adequate supplies of gas that have been price deregulated under the

NGPA. The Commission's decision in *Columbia* is pending appeal to the United States Court of Appeals for the District of Columbia Circuit, *Office of Consumers Counsel v. Federal Energy Regulatory Commission,* No. 84-1099.

Furthermore, it is well documented that, notwithstanding the current deliverability surplus, proven reserves of conventional gas supplies are declining. Indeed, Department of Energy statistics show that the proven reserves of natural gas dedicated to interstate pipeline companies have declined by over 8.5 trillion cubic feet over the past two years.[8] Under such circumstances, it is only prudent for interstate natural gas pipelines to turn to alternate sources of supply, *e.g.,* LNG, SNG, or other gas supply projects, to meet their future service obligations.[9]

In light of the potential impact of its policy on the interstate natural gas pipeline industry as well as natural gas consumers, the Commission's action is inconsistent. On the one hand, the Commission appears beguiled by the current gas *deliverability* (*i.e.* not gas reserves or supply) surplus and is willing to ignore the future needs of natural gas pipelines and consumers. Yet, in earlier cases when the supply shortfall was immediate, the Commission acknowledged it as an emergency and expounded on the need for new gas supply sources. For example, when Eascogas

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[8]"Gas Supplies of Interstate Natural Gas Pipeline Companies 1983," Energy Information Administration, DOE/EIA-0167(83), p. 52 (1984).

[9]In fact, if pipelines fail to do so, they may face accusations by customers, during supply shortfall, that they have been derelict in their duty to secure reliable long-term supplies.

LNG, Inc. sought Commission approval of its proposal to construct an LNG project to provide base-load LNG service to New England gas consumers, the Commission had little doubt of the need for the gas supply as is obvious from the following opening language from the Commission's opinion:

> "The United States is confronted with a national energy emergency.
>
> "It is the clear responsibility of all agencies of the United States Government to respond to, and to take actions to alleviate, this emergency to the fullest extent of their legal authority. The Commission has long been mindful of mounting shortages in energy supply, as evidenced by its Opinions and orders and by the public statements of its members over many months. We are thus prepared, and indeed anxious, to respond to the current emergency within the scope of our responsibilities, and we are willing to do so by taking any necessary and reasonable action permitted by law which will assist in alleviating the current crisis and which is consistent with the public interest.
>
> "We take expedited action today in these consolidated proceedings, for we are convinced that only by so doing, a project that promises substantial supplies of imported natural gas for New Jersey and the New England States will not be jeopardized by regulatory inaction." *Eascogas LNG, Inc.*, Opinion No. 680, 50 FPC 2075, 2077 (1973) (footnote omitted).

Moreover, in other contexts, the Commission has recognized that it must encourage investment in economically sound incremental supply projects through a sharing of the risk between pipelines and consumers. *Trailblazer Pipeline Company,* Opinion No. 138, 18 FERC ¶61,244, 61,503 (1981). In *Trailblazer,* the Commission described the dilemma confronting the pipelines as follows:

> "If regulated companies cannot reap the benefits of good fortune, they should not be expected to bear the burdens of bad fortune. If the best that they can hope for are rates that just cover their cost (including a fair return), they cannot be expected to undertake projects that carry a significant risk of falling short of covering those costs. And it would seem to stretch the limits of the law to try to force companies to undertake such projects in order to maintain service. Thus, either such projects will not be undertaken by the regulated companies, or the risk must be at least shared between investors and consumers.
>
> * * * * *
>
> "These policy considerations have led the Commission in the direction of a consistent and more liberal allowance of abandoned plant costs in cost of service. That trend subscribes in essence to the view that undertaking new supply projects resulting in the incurrence of costs to maintain or improve service, or ultimately to improve productivity (lower costs), is as much a part of the cost of service as other components historically and consistently treated as part of the cost of service. * * *" 18 FERC at 61,502.

and consistently treated as part of the cost of service. * * *" 18 FERC at 61,502.

The result reached by the Court of Appeals in this case, however, is squarely at odds with the Commission's expressed determination to provide a balanced sharing of risks in new supply projects.[10]

C. The Commission's Rejection of Cost Recovery for Certain Projects Is Arbitrary and Capricious Where Cost Recovery Is Permitted for Comparable Projects

The Court of Appeals advanced a series of distinctions to support its decisions to deny cost recovery for the unsuccessful gas supply projects presented here, but to permit cost recovery for other unsuccessful conventional gas supply projects involving storage. These distinctions which seem to be based on the "used and useful concept" are *not* contained

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[10]The Supreme Court has required that any rate action by the Commission reach a just end result, a process which involves a "balancing of the investor and the consumer interests." *Federal Power Commission v. Hope Natural Gas Company*, 320 U.S. 591, 602-603 (1944). The ultimate impact of the Commission's and the Court of Appeals' actions here, however, is that only the consumers' immediate or short-term interests are acknowledged. Although Natural was working to meet service obligations under its certificates, and raising necessary capital to do so in pursuit of replacement gas supply projects, the Commission's decision flatly to exclude such cost recovery clearly ignores the consumers' long-term interest in continuing service, including the viability of the pipeline industry which is an essential component of such service.

in the Commission's opinions but appear for the first time in the Court's decision.[11] The distinctions are strained and without real difference, and the Commission's action is arbitrary and capricious and an abuse of discretion. The failure of the Court of Appeals to correct this unlawful administrative action requires the granting of Natural's Petition.

The Commission has acknowledged that its policy toward costs incurred in the pursuit of unsuccessful projects has been uncertain and inconsistent.[12] Its policy remains inconsistent and arbitrary in the present case, where the Commission denied Natural any cost recovery under existing policy but at the same time articulated new factors involving prudence under which it may grant future requests for such recovery.[13] This inconsistency is aggravated, moreover, be-

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[11]While INGAA does not wish to belabor the point here, INGAA submits that a reviewing Court should not supply the agency with a rationale to harmonize conflicting precedent especially where, as shown in *Trailblazer, supra,* the agency concedes the inconsistency (see the next footnote).

[12]As the Commission itself put it in *Trailblazer, supra,* "[t]he *Ozark* [*Ozark Gas Transmission System,* Opinion No. 125, 16 FERC ¶61,099 and Opinion No. 125-A, 17 FERC ¶61,024 (1981)] case points out that Commission treatment of the issue of abandoned plants in rate proceedings has been uncertain. In fact, it has been characterized by a somewhat distressing degree of inconsistency. That inconsistency is important because it tends to leave both lenders and equity investors with a sense of uncertainty as to how the Commission will treat unsuccessful investments in new energy supply projects. * * * " 18 FERC at 61,501.

[13]The Commission did apply its newly announced factors in the *Tennessee* case, *supra,* 32 FERC 61,231-32, a case in which the record had closed before issuance of the new standard in *Natural.* Finding that Tennessee did not meet the new standards, the Commission denied recovery in that instance of costs associated with a failed LNG project.

cause the Court of Appeals introduced its own rationale based on a "used and useful" test.[14]

Where, as here, such costs have been prudently incurred, the Commission routinely has permitted pipelines to recover costs associated with failed projects, such as failed gas storage projects. *See, e.g., Northern Natural Gas Company,* 45 FPC 1050 (1971); *Southern Natural Gas Company,* Opinion No. 329, 29 FPC 323, 331-32 (1963). Similarly, recovery has been allowed for dry hole costs. *See, e.g., Panhandle Eastern Pipeline Company,* Opinion No. 344, 25 FPC 787 (1961); *Phillips Petroleum Company,* Opinion No. 338, 24 FPC 537 (1960). These decisions came under the same rate provisions of the NGA as are applicable here.

The Court of Appeals distinguished Natural's projects from these situations, first on the ground that storage is unlike production,[15] and then on the ground that dry wells are sufficiently unlike Natural's proj-

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[14]It warrants observation in this connection that even where the used and useful test has been considered for purposes of determining rate base, the court below has indicated its preference for a prudent investment test. *Jersey Central Power & Light Company v. Federal Energy Regulatory Commission,* 768 F.2d 1500, 1504, n. 4 (D.C. Cir. 1985). Accordingly, INGAA is hard put to understand the reasoning behind the Court of Appeals' apparent reliance in the instant case on a used and useful standard.

[15]Even if one accepts this distinction, it would not justify the Commission's treatment of Natural's LNG project. That project simply involved the purchase, importation, and storage of LNG for subsequent delivery to customers when needed. The only difference between an LNG project and other storage projects is the fact that the gas is stored as a liquid rather than in a gaseous state.

ects so as to permit different treatment. 765 F.2d at 1165. But nowhere does the Court of Appeals attempt to reconcile the obvious conflict created between a pipeline's need to meet its long-term service obligations and the Commission's discrimination against recovery of prudently incurred expenses associated with its unsuccessful gas supply projects.

The Court of Appeals also relied heavily on the concept of "used and useful" to decide what expenses are allowable. 765 F.2d at 1156-58, 1161. This is in error. The "used and useful" concept is not applicable to cost recovery where regulation is undertaken under the prudent investment approach to rate making. *See Missouri ex rel. Southwestern Bell Telephone Co. v. Public Service Commission*, 262 U.S. 276, 290 (1923) (Mr. Justice Brandeis, concurring); *Washington Gas Light Co. v. Baker*, 188 F.2d 11 (D.C. Cir. 1950). Additionally, subsequent to the decision below in the instant case, the same Court of Appeals (but a different panel) has questioned the Commission's authority to disallow any element of cost by an electric utility, including return on investment, under the foregoing authorities. *Jersey Central, supra.* Because of the obvious confusion in the Court below as to the proper test to apply, it is imperative that this Court hear the instant case to reaffirm the Constitutional and statutory principles applicable to the prudent investment theory of utility ratemaking.

It is arbitrary and capricious, and an abuse of discretion, for the Commission to expect and encourage interstate pipelines to search out needed long-term gas supplies but then draw after-the-fact distinctions among types of projects as to which are eligible for cost recovery and which are not. Pipelines engage in

multifaceted gas procurement activities in pursuit of their certificate obligations to serve their markets. Where such costs are prudently incurred, and absent some rational justification not present here, the Commission must, consistent with its public interest duty, treat the recovery of all such pipeline activities similarly.

CONCLUSION

A writ of *certiorari* should be issued by this Court so that it may review and correct the Commission's erroneous and arbitrary action, thereby insuring that the interests of the interstate natural gas pipeline industry and natural gas consumers are protected.

Respectfully submitted,

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APPENDIX

APPENDIX

INTERSTATE NATURAL GAS ASSOCIATION OF AMERICA MEMBERSHIP

Active Membership

Alabama-Tennessee Natural Gas Company
Algonquin Gas Transmission Company
Arkla Energy Resources Company
The Coastal Corporation
The Columbia Gas System, Inc.
Consolidated Natural Gas Company
El Paso Natural Gas Company
Granite State Gas Transmission Inc.
Great Lakes Gas Transmission Company
HNG-InterNorth
Kentucky West Virginia Gas
KN Energy, Inc.
Locust Ridge Gas Company
Michigan Gas Storage Company
MidCon Corp.
Mid Louisiana Gas Company
Northwest Energy Company
Pacific Gas Transmission Company
Pacific Interstate Transmission Company
Panhandle Eastern Corporation
Ringwood Gathering Company
Southern Natural Gas Company
Tennessee Gas Transmission Company
Texas Eastern Transmission Corporation
Texas Gas Transmission Corporation
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Kinsey Interests, Inc.
Laclede Gas Company
Lear Petroleum Exploration Company
Marathon Oil Company
Minerals, Inc.
Mitchell Energy & Development Corporation
National Fuel Gas Company
NUI Corporation
Phillips Petroleum Company
Shell Oil Company
Southern California Gas Company
Sun Exploration & Production Company
Texaco U.S.A.
Union Oil Co. of California